Political Economy of Investment Decisions and Economic Development

Yutaro Hatta*

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Abstract

This paper studies investment decisions by economic agents where the tax rate is decided through voting. It is shown that when productivity is very low, the wrong side of the Laffer curve is only supported under rational expectations. Thus, the government of developing countries is likely to collect its revenue in an unmeaningly inefficient way. It, in turn, may give another mechanism of poverty trap. Also, with an intermediate level of productivity, the economy suffers from multiple equilibria on both sides of the Laffer curve. Only high-productivity countries can avoid inefficient fiscal policies.

Keywords: capital tax, multiple equilibria, inefficiency in fiscal policies
JEL Classification: E22, E62, H21, O23, O11

*Graduate School of Economics, Osaka University, 1-7, Machikaneyama, Toyonaka, Osaka 560-0043, Japan, Email address: kge009hy@mail2.econ.osaka-u.ac.jp